THE NASH & CIBINIC REPORT®

THOMSON WEST

government contract analysis and advice monthly from professors ralph c. nash and john cibinic

Author: Ralph C. Nash, Professor Emeritus of Law, The George Washington University
Contributing Author: Vernon J. Edwards

VOLUME 19 • NUMBER 10
OCTOBER 2005

INSIDE:

The Nash and Cibinic Report (ISSN 0891-9291) is published monthly and copyrighted © 2005 by Thomson/West • Published by Thomson/West / 610 Opperman Drive, P.O. Box 64526 / St. Paul, MN 55164-0526 • http://www.west. thomson.com • Periodicals postage paid at St. Paul, MN • Postmaster: Send address changes to The Nash & Cibinic Report / PO Box 64526, St. Paul, MN 55164-0526.

40294090

DATELINE OCTOBER 2005 • THE N&CR ROUNDTABLE • Coming to you by mail, *in a separate envelope*, is your Invitation to the 2005 NASH & CIBINIC REPORT ROUNDTABLE, which includes the ROUNDTABLE program and your Registration Form. Please note that (a) this is the only Invitation you will receive, (b) your registration must be made on the included Form, and (c) we must receive your registration no later than November 18, 2005.

As an N&CR subscriber, you are entitled to send one representative to the ROUNDTABLE free of charge and additional representatives for a fee of $400 each. (The ROUNDTABLE fee for nonsubscribers is $800.)

Capsule Data: The ROUNDTABLE will be held on Thursday, December 8 (8:30 A.M. to 5 P.M.) and Friday, December 9 (8:30 A.M. to 12 noon) at the American Management Association Executive Conference Center in Washington, DC. Six 1½ hour sessions will deal with the following topics: Good Faith & Fair Dealing • Ethical Requirements • The Role of Estimates • Appropriations Law Issues • Performance-Based Contracting • Design-Build Contracting. These sessions will be conducted by Professor Ralph C. Nash, Vernon J. Edwards, and James F. Nagle. Along with the distinguished procurement experts listed in the program, they will discuss the issues and answer your questions.

We believe the ROUNDTABLE will prove to be a stimulating educational experience in Government contracting, and we look forward to your participation.

Thomson/West

Register now for the 2005 NASH & CIBINIC REPORT ROUNDTABLE.

Procurement Management

¶ 46 • FEE LIMITATION FOR ARCHITECT/ENGINEER CONTRACTS: Confusion Reigns Supreme • In a recent decision, *Fluor Enterprises, Inc. v. U.S.*, 64 Fed. Cl. 461 (2005), a judge faced the unenviable task of figuring out how to deal with one of the most cryptic statutes in the Government contracting firmament. This is 41 USCA § 254(b), which imposes "fee" limitations on architect/engineering contracts. The statute reads:

> [I]n the case of a cost-plus-a-fixed-fee contract the fee shall not exceed 10 percent of the estimated cost of the contract, exclusive of the fee, as determined by the agency head at the time of entering into such contract (except that a fee not in excess of 15 percent of such estimated cost is authorized in any such contract for experimental, developmental, or research work and that a fee inclusive of the contractor's costs and not in excess of 6 percent of the estimated cost, exclusive of fees, as determined by the agency head at the time of entering into the contract, of the project to which such fee is applicable is authorized in contracts for architectural or engineering services relating to any public works or utility project).

This language is quite clear with regard to the 10% and 15% limitations where the fee being negotiated is related to the cost of the work to be performed on the contract to which the fee pertains. But the statute becomes cryptic when applied to

Notes

the 6% limitation on A/E contracts where the "fee" relates to the estimated costs of a totally different contract. In this regard, the statute reads:

> [I]n the case of a cost-plus-a-fixed-fee contract the fee shall not exceed …6 percent of the estimated cost, exclusive of fees, as determined by the agency head at the time of entering into the contract, of the project to which such fee is applicable…in contracts for architectural or engineering services relating to any public works or utility project….

This is almost incomprehensible because it starts out talking about cost-plus-fixed-fee contracts yet the A/E fee is the full compensation paid to the architect not just its negotiated profit. Thus, the statute uses the word "fee" with two different meanings in the same sentence. This is the height of legislative nonsense.

While the statute begins by referencing CPFF contracts, it is well established that the A/E limitation applies to fixed-price contracts as well as cost-reimbursement contracts for A/E services. See Federal Acquisition Regulation 15.404-4(c)(4)(i)(B), stating:

> For architect-engineer services for public works or utilities, the contract price or the estimated cost and fee for production and delivery of designs, plans, drawings, and specifications shall not exceed 6 percent of the estimated cost of construction of the public work or utility, excluding fees.

This rule that the statute applies to all types of A/E contracts was enunciated by the Comptroller General in Comp. Gen. Dec. B-152306, 46 Comp. Gen. 556, 1966 CPD ¶ 110, and Comp. Gen. Dec. B-152306, 46 Comp. Gen. 573, 1966 CPD ¶ 111. See also *Hengel Associates, P.C.*, VABCA 3921, 94-3 BCA ¶ 27,080.

The *Fluor Enterprises* Case

The procurement that led to this dispute was a very broad CPFF term-type contract requiring Fluor Enterprises to provide project planning and construction management services for the modernization of the National Weather Service. As part of this effort, the contractor was required to design a number of weather forecasting offices. However, at the outset of the contract, neither party recognized that this part of the effort constituted A/E services to which the 6% fee limitation applied. Therefore, the total contract work was carried out by the agency issuing level of effort task orders for specified amounts of labor. Each task order stated the amount of fixed fee that would be earned by the contractor's expending the required number of labor hours. The contractor ultimately received $42,531,626 for its work.

After completion of the contract, the agency Inspector General issued an audit report criticizing the agency for entering into such an open-ended contract and for not complying with the fee-limitation statute. The Inspector General recognized that the contractor had performed many services that were not A/E services and made an audit recommendation as to the amount of the effort that should be subject to the statutory limitation. In the course of this audit, the Inspector General obtained a Comptroller General decision that all costs (including indirect costs, travel expenses, consultant fees, and reproduction costs) of A/E services should be included in the computation of the 6% limitation), *Department of Commerce—Determining Compliance With Statutory Limitation of Architectural and Engineering Design Services*, Comp. Gen. Dec. B-258058, 1995 WL 274823 (May 8, 1995). After attempting to negotiate a settlement of the fee issue, the Contracting Officer issued a final decision demanding repayment of $2,560,413. This was the amount above 6% of the agency's approximation of the construction cost of the buildings that had been designed by the contractor. This decision was timely appealed to the U.S. Court of Federal Claims.

The Court Decision

The Court of Federal Claims was required to address a number of issues to determine the contractor's liability for repayment.

Notes

• *Was this a contract for A/E services?* The contractor argued that the contract was not for A/E services because only a small part of its effort was design work. The court rejected this argument with the following sound reasoning:

> The…portions of the FAR that implement [41 USCA] § 254(b) do not limit the scope of applicability to contracts *only* for A&E services, which is the crux of Fluor's argument, but rather require that the 6% limitation be applied to fees incurred for the performance of relevant *services*. Section 15-404 (former § 15-904-4(c)(4)(i)(B)) prohibits a contracting officer from negotiating a fee that exceeds the statutory limit whenever it procures "architect-engineer services for public works or utilities." The fees that are so limited are those attributable to the "production and delivery of designs, plans, drawings, and specifications." 48 C.F.R. § 15.404-4(c)(4)(i)(B). This regulation does not refer to "contracts" for A&E services, nor does it in any way limit the 6% limitation to undertakings that are exclusively, or primarily, for A&E services. Presumably, it is only the fees paid for the performance of actual design services, whether as part of a contract calling for *only* A&E services or as part of a contract calling for performance of a diverse range of services, that are subject to the 6% limitation of § 254(b). In other words, costs and fees incurred in providing non-A&E services under the contract escape the narrow 6% limitation.
>
> That interpretation of the fee limitation—that it only applies to a limited range of services despite the variety of services called for in the contract—is consistent with opinions from administrative bodies that have interpreted the statute. The Comptroller General has expressed the opinion that "the codifications of the 1939 statutes *apply to all types of contracts* and that costs which do not relate to the preparation of designs, plans, drawings, and specifications may be regarded as not subject to the 6-percent limitation imposed by those statutes." 46 Comp. Gen. 556, 560 (Dec. 12, 1966) (emphasis added). "In light of the legislative history of the Brooks Act, we have held that the Act applies to the procurement of services which uniquely or to a substantial or dominant extent logically requires performance by a professionally licensed and qualified A-E firm." *In re Assoc. of Soil and Foundation Engs.*, 61 Comp. Gen. 377, 378 (May 6, 1982). Logically, if services that do not properly fall within the Brooks Act's circumspection of "architectural or engineering services" or, even more apparent, are not architectural or engineering services at all, then the fees for those services are not rightly subject to the § 254(b) fee limitation. However, the presence of such services—even if they represent a substantial or predominant portion of the contract—does not exempt from the fee limitation the fees for those services that are properly within the scope of the Brooks Act provisions. [Footnotes omitted.]

• *Was this a design-build contract exempt from the fee limitation?* The court also rejected the contention that the contract in this case was a design-build contract. The court recognized that design-build contracts were not subject to the fee-limitation statute because such contracts were procured using price competition for the entire project without regard to how much design effort the contractor intended to undertake. However, the court concluded that this contract could not have been a design-build contract because it was entered into before the two-phase design-build statute enacted as part of the Clinger-Cohen Act, Public Law 104-106 (now in 41 USCA § 253m). In reaching this conclusion, the court believed that agencies could not enter into design-build contracts without specific statutory authority—although it recognized that the General Services Administration and the Departments of Energy, State, and Veterans Affairs had used such contracts before the enactment of 41 USCA § 253m without citing any statutory authority for such action. We believe the court is incorrect in this belief but that its mistake would not change the outcome of the case because, factually, the contract does not appear to call for construction work and therefore could not be a design-build contract.

• *Did the agency comply with the fee-limitation statute?* Having concluded that the fee-limitation statute applied to that portion of the work that called for A/E services, the court addressed the critical question—whether the agency complied with the statute. The court correctly found that the statute required the agency to limit the negotiated "fee" (in this case, the cost plus the fixed fee for the services) of the A/E to 6% of the cost "as determined by the agency head *at the time of entering into the contract*, of the project to which such fee is

Notes

applicable." (Emphasis added.) It found that the agency knew so little about the scope of the project at the outset that it could not establish a reasonable cost estimate of the construction work and that the agency, therefore, did not have any such cost estimate when the contract was awarded. The court concluded that the agency had violated this critical requirement based on the following reasoning:

> [U]nder a contract for A&E services, the contractor would have no obligation to perform and continue to incur costs if and when his incurred costs exceeded the 6% limitation, because any incurred costs above that limitation threshold would not be reimbursable. *See Advanced Materials, Inc. v. Perry*, 108 F.3d 307, 310–11 (Fed. Cir. 1997). In the normal course of a contract for A&E services, when the timely estimate is properly conducted, an A&E contractor is on notice of the upper limit on his *allowable* fees and it is incumbent upon that contractor to complete the project within the allowable range. On the other hand, if no estimate were in place, the contractor would not be able to determine the upper limit on his allowable fees and would run the risk of incurring costs in excess of § 254(b)'s fee limitation—costs that would, by law, not be reimbursable. "The requirements of the cost limitation provision protect both the contractor and the government." *Id.* at 310. The provision "protects the contractor from discovering, after performing the contract at greater cost than anticipated, that its work has been financially disastrous" because the government is not able to pay additional costs—in the A&E context, costs in excess of the 6% limitation.

This is a rather confusing line of thought because it does not clearly distinguish between a fixed-price A/E contract where the contractor would be required to complete the design work if its costs exceeded the price and a cost-reimbursement A/E contract where the contractor would be permitted to stop work when it reached the 6% fee limitation. However, the reasoning that the agency is required to make a cost estimate and establish a fee based on that estimate is compelling.

• *What is the result of noncompliance with the statute?* The court concluded that there was a clear violation of the fee-limitation statute and that the contract was, therefore, void based on the following reasoning:

> The effect of § 254(b) is a plain limitation on the amount of money that a contracting officer may spend on A&E services of the type here. Congress has expressly stated that fee limitation in terms of (and as a function of), the project estimate that is supposed to accompany any cost-plus-fixed-fee contract for A&E services procured without price competition. Because the mandatory fee limitation is expressed only in terms of that project estimate, it is impossible to determine what the fee limitation should be without the proper estimate in place. As a general rule, then, any contract for A&E services that the contracting agent attempts to procure without establishing the fee limitation does not comport with the express provisions of the statute and regulations.
>
> Without the mandatory project estimate, the contracting officer lacked the authority to procure A&E services under § 254(b). "Failure to follow the applicable rules negates the agent's authority to enter into a contract binding on the government. To permit otherwise would be to nullify those very statutes, regulations, and determinations—a result clearly contrary to the public interest." *United States v. Amdahl Corp.*, 786 F.2d 387, 392 (Fed. Cir. 1986) (quoting Brous, *Termination for Convenience: A Remedy for the Erroneous Award*, 5 PUB. CONT. L.J. 221, 222–23 (1972)). In turn, courts adhere to "the maxim that the United States is not bound by its agents acting beyond their authority and contrary to regulation." *Urban Data Sys., Inc. v. United States*, 699 F.2d 1147, 1153 (Fed. Cir. 1983) (citing *Fed. Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 384, 68 S. Ct. 1, 92 L. Ed. 10 (1947))….

In reaching this decision, the court recognized that fully performed contracts would be held to be void only in some circumstances, stating:

> Despite the contracting officer's patent violation of procurement law, there is a "[j]udicial reluctance" to view a fully performed contract, as in this case, through the lense of illegality or invalidity. *See AT&T Co.*[*v. U.S.*], 177 F.3d [1368] at 1376 [(Fed. Cir. 1999)]. "The court should ordinarily impose the binding stamp of nullity

Notes

> only when the illegality is plain." *John Reiner & Co. v. United States*, 163 Ct. Cl. 381, 325 F.2d 438, 440 (1963); *see also AT&T Co*., 177 F.3d at 1376. The contractor should receive the "benefit of reasonable doubts" as to the validity of a contract "unless its invalidity is clear." *John Reiner*, 325 F.2d at 440. "Therefore, when the deviation [by the contracting officer] is not egregious, the court has preferred to allow the contractor to recover on the ground that the contracts were not palpably illegal to the bidder's eyes." *Trilon Educ. Corp. v. United States*, 217 Ct. Cl. 266, 578 F.2d 1356, 1360 (1978). On the other hand, there are circumstances in which "the departures from applicable statutes and regulations were both obvious to the bidder and *so substantial* as to require the conclusion that the putative contracts were void *ab initio*." *Id.* (emphasis added). It is this latter situation in which "the illegality is plain." *John Reiner*, 325 F.2d at 440.
>
> The issue for the court therefore becomes whether the illegality in this case is "plain" and whether the departure from statute is "so substantial" as to render the portion of Fluor's contract dealing with A&E services void *ab initio*. In the normal course, a contracting officer would only have proper authority to procure architectural and engineering services when the procurement would comply with § 254(b). In this case, however, the contracting officer ignored statutory and regulatory requirements that should have guided this procurement. *See Prestex, Inc. v. United States*, 162 Ct. Cl. 620, 320 F.2d 367, 371 (1963). That failure was the product not of oversight but rather impossibility, because the contract award came at a time when the scope of the building project was so open-ended. Given the informational deficiencies about the scope of the building project at the time [the agency] entered into this contract, the contracting officer could not and did not procure the relevant A&E services in a manner that was consistent with § 254(b). This inherent impossibility notwithstanding, without the ability to establish an estimate, and without establishing the attendant fee limitation, the contracting officer lacked the ability to procure a contract that complied with § 254(b) and therefore lacked the necessary authority to enter into any contract with Fluor for architectural and engineering services.
>
> Fluor is not immune from these deficiencies. "[A] party contracting with the United States assumes the risk that the official with whom he deals is clothed with the actual authority to enter the subject contract sought to be enforced." *Yosemite Park and Curry Co. v. United States*, 217 Ct. Cl. 360, 582 F.2d 552, 560 (1978) (citing *Jackson v. United States*, 216 Ct. Cl. 25, 573 F.2d 1189, 1197 (1978)). The record is clear that Fluor was aware of the fee limitation in § 254(b), but was under the mistaken belief that the section did not apply given the broad spectrum of services called for by the contract.…Whatever the basis for this misconstruction of the law, Fluor bore the risk that the contracting officer's failure to comply with the statute might undermine his authority to enter into a contract of the type here and that the contract might be later deemed unenforceable. *See CACI, Inc. v. Stone*, 990 F.2d 1233, 1236 (Fed. Cir. 1993).

• *Does the contractor have any recourse?* Fortunately for the contractor, the court concluded that the full performance of a void contract in these circumstances resulted in an implied contract to pay for the reasonable value of the services under a quantum meruit theory—following *Amdahl* and *Prestex*. It remanded the case to the agency with instructions that it had the burden of determining whether the amount paid to the contractor was in excess of a reasonable estimate of the construction costs made at the time of the award of the A/E contract. In giving this cryptic advice, the court indicated quite clearly that it did not accept the agency's logic in the original CO's decision.

Lessons Learned

Flour Enterprises is a highly instructive decision giving rise to the following lessons:

1. Neither the contractor nor the Government should enter into an A/E contract when the agency cannot arrive at a reasonable cost estimate of the construction work to be accomplished. If the agency knows so little about the project and cannot arrive at a reasonable estimate with its own personnel, it should enter into a contract for preliminary work and defer the design effort to a later phase of the program.

Notes

2. Agencies should be wary of entering into cost-reimbursement A/E contracts. When they do, they face a serious dilemma. If the contractor reaches a point where its costs plus its fee (profit) have reached the 6% "fee" limitation (costs plus profit), it will be permitted by the "Limitation of Cost" clause to stop work and the agency will have no way to complete the design effort without violating the fee-limitation statute. The court recognized this dilemma with regard to the use of a cost-reimbursement term-type contract but did not see that the same dilemma exists with a cost-reimbursement completion-type contract. The only solution to this problem is to determine that additional design work has been called for— in which case the original cost estimate could be revised upward, justifying more compensation to the A/E.

3. Contractors must be aware of the statutes that limit the actions a procurement agency can take. In this case, the contractor will probably receive something approaching fair compensation for its work—but only after years of litigation. Entering into a void contract is not a good course of action!

Guest Appearance

A special column by
W. Stanfield Johnson
Crowell & Moring LLP
Washington, D.C.

¶ 47 • NEEDED: A Government Ethics Code And Culture Requiring Its Officials To Turn "Square Corners" When Dealing With Contractors • Very appropriately, the Air Force's Darlene Druyun scandal has prompted an intensive Department of Defense review of acquisition processes, internal controls, and ethics programs for Government contracting officials. The DOD has been urged to develop an "ethical culture." Not surprisingly, this effort has focused on guarding against future scandals in which Government officials might "sell out" taxpayer interests or compromise the integrity of the contracting process. But there is another dimension to the ethical challenge faced by the Government and its contracting officials, and that is whether they act ethically when dealing with their contractors. This dimension needs also to be addressed.

Even though she went to jail for offenses against her employer, Ms. Druyun's scandal should also raise this side of the contractual and ethical equation. As the Defense Science Board March 2005 Report recently advised the Under Secretary of Defense, Ms. Druyun was also guilty of "unprofessional behavior and questionable practices with…the contractors with whom she dealt." *Report of the Defense Science Board Task Force on Management Oversight in Acquisition Organizations* 12 (Mar. 2005) (available at *http://www.acq.osd.mil/dsb/reports/2005-03-MOAO_Report_Final.pdf*). Both within Government *and industry*, Ms. Druyun was feared as "the Dragon Lady," and it was not an affectionate reference. Wary contractors did not suspect she would disserve Government interests but would not have been surprised to learn that she had cut corners, coerced, reneged, lied, and manipulated documents to benefit the Government, at contractor expense.

Ms. Druyun was one-of-a-kind, but such Government abuse of its contractors is not that unusual. Although most contracting officials conscientiously engage in fair dealing, not all do, and it is easy for them to fall into the Machiavellian trap that the ends—*i.e.*, the "Government's interests"—justify their means. The public has little sense of this. The general impression is that many contractors are greedy, unethical crooks, and many Government contracting officials are either cheated, co-opted, or chumps. But the fact is that, in the contracting trenches, an intense adversary battle frequently goes on, in which Government officials act no better and sometimes worse than their industry counterparts. Some of the Government conduct, though unethical, is not crooked simply because Congress has only

Notes

made it criminal for contractors to abuse the Government, but *not vice versa*. And, all too often, the Government is not held accountable for such misconduct in the contract disputes forums because of judicial lenity in favor of the sovereign.

The Record Of Unfair, Unethical Dealing

Admittedly, my views are shaped by years of representing defense contractors in this battle of the trenches and in the litigation aftermath. In the 1960s (when I was young and innocent of these views), a client was terminated for default because its product failed tests. In litigation, we discovered handwritten notes recording a Government meeting in which the Army engineer pointed out that the Government specification was defective and inquired why the contract was terminated for cause; the Contracting Officer's recorded response was: "we don't have enough money to terminate for convenience." Thus, the Government claim was knowingly false. After this discovery, the case settled handsomely, but there was no reprimand of the contracting officials—it was apparently a "good try" foiled only by litigation.

Some years later, I encountered a situation where the Government, citing a false pretext, sent in a team to audit the contractor. The program manager instructed that the real purpose of the audit not be disclosed. At his deposition, I asked whether he considered this conduct ethical, whereupon his lawyer objected that ethics were irrelevant; this Air Force lieutenant colonel then responded that his ethical code was to do "whatever was in the interest of the U.S. Air Force."

These are just a few anecdotal examples in my experience, and other lawyers for defense contractors could, I am confident, multiply them by a significant factor. But the best evidence is in published decisions in litigated cases—some losses, some victories for the Government. Four recent decisions illustrate the ethical stress for contracting officials caused in contract administration and in litigation by the perceived imperative of serving the Government's interest. Consider, for example, these published decisions:

In *United Technologies Corp., Pratt & Whitney Group*, ASBCA 46880, 97-1 BCA ¶ 28,818, 39 GC ¶ 327, the Armed Services Board of Contract Appeals ruled that the Navy breached its F404 dual-sourcing contract with Pratt & Whitney when it awarded 100% of its Fiscal Year 1990 requirement to General Electric. The dispute involved Navy breach of the "dual source" agreement, which in return for a multi-million dollar contractor investment, promised Pratt & Whitney the opportunity to compete for the life of a major acquisition program and guaranteed 30% of the Navy's requirements for five years. In the third year, the Navy awarded all its requirements to GE and denied liability. In litigation, the Navy officials who had made the deal, indeed the Secretary himself, confirmed the commitment, including the guaranteed 30%, and thus the breach. In contrast, the CO, notwithstanding her earlier writings describing the "guaranteed" and "assured" quantity, held the view that "the Navy 'could go' with its new Winner-Take-All strategy." The board gently found that "her view grew more out of expediency of the moment than out of conviction." The CO maintained that the 100% award to the competitor was justified because "ultimately the decision should be made on what's best for the Government."

In the course of the litigation, it became clear that Pratt & Whitney had actually won the annual FY 1990 competition, as recorded in a source selection decision, entitling it to *70%* of the requirements. The result of the competition was a "dirty little secret" that the Navy kept from its contracting partner for years, after deciding it was no longer in its interest to honor the agreement. As the ASBCA noted without comment, "Pratt & Whitney did not become aware of the Award Determination until litigation commenced some years later."

Happily, this illustration also proves that there are Government contracting personnel who do understand and practice ethics. The Navy's secret was exposed because the Chairman of the Navy source evaluation board, a former employee by the time of the resulting litigation, had maintained his copies of the source selection records and confirmed them in testimony at trial. He had expressed his opposition to "not living up to our agreement," as the

Notes

ASBCA found. And then there was the lawyer for the evaluation board, who, after an expected objection to a deposition inquiry as to her legal opinion, was asked whether she had formed an opinion as to the Navy's *ethical* obligations. Still a Navy employee, she replied that she had—and it was that the Navy had an ethical duty to make an award in accordance with the agreement.

In *Lockheed Martin Tactical Air Systems*, ASBCA 49530,00-1 BCA ¶ 30,852, *recons. denied*, 00-2 BCA ¶ 30,930, the Air Force breached its duty to cooperate by refusing to pay for and thereby frustrating performance of an F-16 coproduction subcontract with Egyptian industry under the foreign military sales program. The ASBCA recounted and rejected the shifting, erroneous justifications offered by the program office for its refusal. One proffered rationale was that the subcontract was strictly a "commercial" deal for which the U.S. Government had no responsibility—a "characterization [which] totally ignored the State Department's active role in promoting the countertrade agreement" between Turkey and Egypt, at the behest of President Bush in the buildup to the Gulf War. Basically, the board found that the Air Force contracting officials had *contractually* authorized the subcontract and were bound by their actions, from which they were trying to "distance" themselves. Of their testimony, the board said:

> On a number of occasions at trial these witnesses [the Program Manager and the Procuring Contracting Officer] were shown Government project records that they authored or with which they were familiar, and which on their face were inconsistent with the Air Force's litigation position. For the most part they refused to acknowledge the clear import of these writings and characterized them as not reflecting their true intent and "as mistakes."

The board "did not find this testimony persuasive," but it is also clear that the conduct of these officials was neither fair dealing nor ethical.

In *SUFI Network Services, Inc.*, ASBCA 54503, 04-2 BCA ¶ 32,714, *recons. denied*, 04-2 BCA ¶ 32,788, Air Force contracting officials materially breached an exclusive arrangement for long distance telephone services after the contractor had made a substantial up-front investment. Because cheaper service was available, the Air Force ordered the contractor to remove restrictions limiting long distance service to the contractor's network. The Air Force denied any breach and posited a bilateral modification as removing the exclusive term. Contemporaneous documentation contradicted this defense, as did the contractor's representative *and the CO's Technical Representative*, who negotiated the modification. Nonetheless, the CO was persuaded to testify that she had advised the contractor that the modification opened up access to other long distance carriers, even though this proposition was directly at odds with her prior deposition testimony. The board's reaction was this:

> Considering the foregoing inconsistent and impeached testimony and [the CO's] demeanor (selective recall, uncertain recollections, and evasive answers), we accord no probative value to her foregoing testimony.

The finding of "no probative value" was sufficient for the board's purposes, but isn't it also clear that this conduct was plainly unacceptable?

In *Freedom NY, Inc.*, ASBCA 43965, 01-2 BCA ¶ 31,585, 43 GC ¶ 396, the Defense Logistics agency signed up a startup small business to provide meals-ready-to-eat, recognizing the contractor's need for private financing and early progress payments. The contracting officials then engaged in an egregious course of conduct, inconsistent with contract understandings and reasonable expectations, by refusing the payments based on criticisms of a previously approved accounting system, even though knowing that financing depended on the payments, and otherwise frustrating the contractor's efforts to obtain financing. Thereafter, the CO terminated the contract for default because of delayed performance. The CO also coerced one modification with a release of claims and induced a further release with promises that were never fulfilled. The Government defended this outrageous conduct in litigation—a decision that cannot be explained except for the notion that the public fisc must be protected even at the expense of the Government's good faith and credibility as a reliable contracting party.

Notes

With respect to the release that was understood by the contractor to be conditioned on promised consideration recorded in a "side letter" attached to the modification, the Government relied on an integration clause and the CO's testimonial denials. Once again, the ASBCA discredited the testimony of a Government CO:

> Considering the documents in evidence and [the Contracting Officer's] demeanor, persistently selective recall of facts and evasive, argumentative, and ambiguous testimony, we attach no probative weight to [the Contracting Officer's] denial of "the side agreement" attached to [the modification].

Once again, "no probative weight" was a sufficient judgment for the board, but shouldn't the Government launch its own investigation of this kind of conduct?

Judicial Tolerance Of Unethical Government Conduct

It is too bad that the Government sometimes "gets away" with such unethical conduct because success only encourages it. We really have no idea how many contractors, large and small, simply succumb either because they are intimidated by their customer or lack resources to fight back. Unfortunately, we do know that the courts sometimes reward such conduct by applying special rules favoring the sovereign, eliminating or limiting its exposure for unethical contractual dealings.

The Federal Circuit has declared that the Government, like all contracting parties, is bound by the RESTATEMENT (SECOND) OF CONTRACTS' obligations of "good faith and fair dealing," e.g., *Centex Corp. v. United States*, 395 F.3d 1283, 1304 (Fed. Cir. 2005). But the application of this fundamental concept has been inconsistently enforced against the Government.

This judicial tolerance is explained in large part by a judicial presumption that Government contracting officials act in good faith, a presumption that can be overcome only by "clear and convincing" evidence of *subjective* bad faith, which means *personal animus*. There is simply no empirical basis for this presumption, and it is illogical (and contrary to the general contract law) to make specific intent to injure the standard by which the "good faith" of contracting officials is judged. While the Federal Circuit (and the Court of Claims before it) has largely restricted this questionable rule to discretionary acts (principally terminations for convenience), a panel of the Circuit has recently erroneously applied it beyond that boundary, *Am-Pro Protective Agency, Inc. v. U.S.*, 281 F.3d 1234 (Fed. Cir. 2002), 44 GC ¶ 94 (duress judged by personal *animus*); contra *System Technology Associates, Inc. v. U.S.*, 699 F.2d 1383, 1387 (Fed. Cir. 1983) (board of contract appeals' "listing of wrongful acts that may constitute duress—acts taken in bad faith, or with malice, or with unconscionable motives—is by no means comprehensive."). Lawyers representing the Government have sought with some success to argue that this "specific intent to injure" standard gives the Government license to act in *objective* bad faith as it is defined in the RESTATEMENT (SECOND) OF CONTRACTS.

On June 27, 2005, Judge Wolski of the Court of Federal Claims rejected this proposition with a scholarly opinion in *Tecom Inc. v. U.S.*, 66 Fed. Cl. 736 (2005), 47 GC ¶ 341, in which he dissected the presumption of good faith and the subjective bad faith rule, tracking a judicial history that distorted original precedents and their premises. At bottom, *Tecom* holds that, at least when it comes to contract activities that are "not formal, discretionary decisions," "the presumption of good faith has no application" and the standard for bad faith does not require proof of malice, bias, or *animus*. This opinion is an important contribution to learning on this subject and hopefully will ultimately become the controlling law. But it is not clear that either the Federal Circuit or other judges of the Court of Federal Claims will embrace *Tecom*.

Indeed, in July, the Court of Federal Claims issued two decisions that presumed good faith and required proof of specific intent to injure, *System Fuels Inc. v. U.S.*, 66 Fed. Cl. 722 (2005) (citing *Am-Pro Protective Agency*); and *L.P. Consulting Group, Inc.*

Notes

v. U.S., 66 Fed. Cl. 238 (2005), 47 GC ¶ 341. In *L.P. Consulting*, the court confused the RESTATEMENT's good faith and fair dealing rule by mixing in the peculiar Government "bad faith" concept:

> To be sure, the government has an implied obligation to carry out its duties under a contract in good faith.…In order to demonstrate a breach of such duty, plaintiff must demonstrate that the government acted in bad faith.…It is well settled, however, that government officials are presumed to act conscientiously and in good faith in the discharge of their duties.…In order to overcome this presumption, plaintiff "must *allege and prove*, by clear and strong evidence, specific acts of bad faith on the part of the government."…While this standard is not intended to "insulate the government action from *any* review by courts,"…in this circuit, it has been "equated with evidence of some *specific intent to injure the plaintiff*." [Citations omitted.]

There is, of course, no such burden of proof in the general contract law cited in *Centex*.

The application of this strange doctrine, immunizing the Government from unethical conduct of its contractual representatives, vitiates the general rule requiring objective good faith and fair dealing whatever the motivation—even saving the taxpayers' money. When a court indulges the Government in this way, it encourages unfair dealing and the frustration of reasonable contractor expectations. The sad story of *Freedom NY* is a good example. Notwithstanding the Government's repeated material breaches of the contract, the contractor in that case was denied "breach damages" and allowed a contractual recovery only of limited costs under the "Government Delay of Work" clause. Breach damages against the Government apparently depended upon clear and convincing proof of *subjective* bad faith. The Government's liability for its contractual abuse of the contractor was further truncated by enforcement of the modification's release, even though, as the board found, the Government had breached the promises made as consideration. On appeal, the Federal Circuit applied a strict, traditional rule—contrary to the RESTATEMENT's contract interpretation principles—that made the integration clause effectively conclusive, notwithstanding the side agreement attached to the modification and the ASBCA findings with respect to it. *Rumsfeld v. Freedom NY, Inc.*, 329 F.3d 1320 (Fed. Cir. 2003), 45 GC ¶ 230, *reh'g denied*, 346 F.3d 1359 (Fed. Cir. 2003), *cert. denied*, 541 U.S. 987 (2004). Thus, the CO's conduct and the Government's defense of it was condoned legally, but anyone with an ethical sense should have been ashamed.

The Need For An Ethical Code Of Fair Dealing

The need for a code of Government ethics that addresses how contracting officials deal with contractors is evident from this record. The need is made all the more acute by the apparent and unfortunate legal leeway courts have allowed the Government for questionable actions of its representatives.

The Government should be held accountable under the law of contracts between private individuals, e.g., *U.S. v. Winstar Corp.*, 518 U.S. 839 (1996), 38 GC ¶ 322; *Mobil Oil Exploration & Producing Southeast, Inc. v. U.S.*, 530 U.S. 604 (2000), 42 GC ¶ 277. But, at a minimum, an ethics code consistent with the contract law of fair dealing should be adopted to give some effect to Justice Jackson's dissent in *Federal Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 387 (1947), where he famously said:

> It is very well to say that those who deal with the Government should turn square corners. But there is no reason why the square corners should constitute a one-way street.

Unfortunately, the existing emphasis of Government ethics codes is exclusively focused on protecting the Government and the taxpayers. See Executive Order No. 12674, "Principles of Ethical Conduct For Government Officers and Employees," 54 Fed. Reg. 15159 (Apr. 12, 1989), as modified by Executive Order No. 12731, 55 Fed. Reg. 42547 (Oct. 17, 1990); DOD Reg. 5500.7-R. See also Government Accountability Office, *Defense Ethics*

Notes

Program: Opportunities Exist To Strengthen Safeguards for Procurement Integrity (GAO-05-341, Apr. 29, 2005). Although a "guiding principle" of the Federal Acquisition Regulation is to "conduct business with integrity, fairness, and openness," FAR 1.102(b)(3), there are no rules or standards proscribing improper business practices vis à vis contractors. There is no training on this subject. There are no reviews, audits, or investigations to ensure that contracting officials deal fairly with contractors. There is no system of discipline when they do not.

This focus is perhaps not surprising. The 1980s-era war-against-procurement-fraud review disclosed that the policies and procedures defense contractors had in place to govern employee conduct were designed to protect the corporation and its shareholders (along with a few special rules as a result of prior scandals—e.g., antitrust and foreign corrupt practices). As that became clear, debarring officials, along with defense industry leaders, called for corporate policies, rules, and controls to protect *the Government* from contractor employee wrongdoing. The Government has demanded an overlay of corporate ethics policies and ethics training of employees that is focused on protecting "the customer." See Defense FAR Supplement Subpart 203.70. The resulting ethical culture is intended to promote straightforward, fair dealings with the Government.

The DOD now needs to take a similar hard and balanced look at the conduct of its own employees. As one debarring official acknowledged to me, "We ask more of contractor employees than contracting officials when it comes to business dealings between them." It is not difficult to find suitable ethical standards. FAR 1.602-2(b) requires that "Contracting officers shall…ensure that contractors receive impartial, fair, and equitable treatment." This existing regulatory standard fits nicely with the standard set by § 205 of the RESTATEMENT (SECOND) OF CONTRACTS:

> Every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement.

The RESTATEMENT's comments to § 205 explain this standard of contractual care in ways that, whether or not imposed on the Government as law, would make an excellent basis for such an ethical code by defining "good faith" and setting forth "do's and don'ts":

> a. *Meanings of "good faith.* Good faith…means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." The phrase "good faith" is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving "bad faith" because they violate community standards of decency, fairness or reasonableness.…
>
> * * *
>
> d. *Good faith performance*. Subterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct to be justified. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may require more than honesty. A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance.
>
> * * *
>
> e. *Good faith in enforcement*. The obligation of good faith and fair dealing extends to the assertion, settlement and litigation of contract claims and defenses.…The obligation is violated by dishonest conduct such as conjuring up a pretended dispute, asserting an interpretation contrary to one's own understanding, or falsification of facts. It also extends to dealing which is candid but unfair, such as taking advantage of the necessitous circumstances of the other party to extort a

Notes

> modification of a contract for the sale of goods without legitimate commercial reason.…Other types of violation have been recognized in judicial decisions: harassing demands for assurances of performance, rejection of performance for unstated reasons, willful failure to mitigate damages, and abuse of a power to determine compliance or to terminate the contract.…

The DOD, while cleaning up after Darlene Druyun, should adopt these standards of conduct as an ethical code for its contracting personnel, along with a regime of training, oversight, and discipline. Such a positive step, taken out of such negative events, would improve the acquisition process by making the Government a more reliable and credible contracting partner. W. Stanfield Johnson

Competition & Award

¶ 48 • POSTSCRIPT: DEDUCTIVE CHANGES OUTSIDE THE SCOPE OF THE CONTRACT • In *Deductive Changes Outside the Scope of the Contract: A Rare Bird*, 19 N&CR ¶ 40, Ralph discussed and analyzed the Comptroller General's decision in *Poly-Pacific Technologies, Inc*., Comp. Gen. Dec. B-296029, 2005 CPD ¶ 105, 47 GC ¶ 288. In that decision, the Comptroller held that a deductive change to a contract that significantly relaxed the contract requirements was outside the scope of the contract and recommended that the agency either terminate the contract modification or terminate the contract in its entirety and conduct a new competition. Robert Fryling of Blank Rome LLP asked Ralph if he thought that decision is bad law and bad policy. We think that it is both.

The *Poly-Pacific* Decision

The Air Force contract was for the lease of acrylic plastic media and for the recycling of the media after use. It was an indefinite-delivery, indefinite-quantity contract for one year with four one-year options. The contract was awarded to U.S. Technology Corporation (UST) on April 23, 2002. It is not clear whether the leasing and recycling were to be ordered at one time or separately, but it appears that they were separately priced. As initially described in the decision, the modification, issued on May 27, 2003, more than a year after contract award, would have allowed the Air Force to order *either* recycling *or* disposal of the used material, but as the Comptroller General explained:

> The scope of work in the [Request for Proposals] here required the contractor to lease type V plastic media to the agency, to collect the [used media], and to recycle it in accordance with [Environmental Protection Agency] regulations. ... The contract as modified added provisions that allowed the agency either to direct UST to recycle the [used media], or to order the disposal of the [used media] as a hazardous waste at UST's expense by UST or by a third party.…Despite the modification's retention of the agency's ability to direct UST to recycle the [used media], however, the agency acknowledges that the modification in fact "suspended the recycle portion of the contract."…The agency further acknowledges that, as a result of the modification, "UST is now only required to lease the blasting media to the agency, and [] UST is required to reimburse the government for disposal costs."

So the modification was a purely deductive change, and it did not affect either the contract price for the lease of the media or the period of performance.

Here is how the Comptroller described the basis for the protest: "Poly-Pacific argues that the modification of UST's contract improperly relaxed the performance requirements, thereby changing the scope of work anticipated by the RFP and resulting in an improper sole-source contract of the modified work." Presumably, the protester wanted to prevent the Air Force from issuing new orders under the contract and from exercising any more options.

Notes

Protests Against Contract Modifications

The Comptroller General has long been willing to consider protests against contract modifications that add work to a contract. In what may have been its first such decision, *Comptroller General McCarl to the Secretary of the Interior*, Comp. Gen. Dec. A-12445, 5 Comp. Gen. 508 (1926), the Comptroller stated a clear and sensible rule, as follows:

> In general, an existing contract may not be expanded so as to include additional work of any considerable magnitude without compliance with Section 3709, revised statutes, requiring advertising and acceptance of lowest bid, unless it clearly appears that the additional work was not in contemplation at the time of the original contracting and is such an inseparable part of the work originally contracted for as to render it reasonably impossible of performance by other than the original contractor.

This holding makes sense because the competition statutes, then and now, require agencies to seek competition when they buy something. See 10 USCA § 2304; 41 USCA § 253. The contracting regulations permit agencies to modify contracts, but when a modification adds a requirement to a contract (i.e., buys something) that was not originally stated in that contract, the question must be asked whether the work to be added is reasonably encompassed by the existing contractual requirements, i.e., whether it is within the scope of the contract. If it is, then it is not subject to competition; if it is not, then the agency must seek competition, Federal Acquisition Regulation 6.001(c).

Contract modifications add work, delete work, or substitute work, with substitution being both an addition and a deletion. (The "relaxation" of a requirement is either a deletion or a substitution.) When a modification adds work, there is the possibility that the work to be added is outside the scope of the original contract—i.e., new work—and should be the subject of a new competition. When a modification substitutes work, there is the possibility that the added work is so different from the deleted work that it is new work that should be the subject of a new competition. But when a change only deletes work there is nothing new to be procured and thus nothing to which the rules of competition apply. Deletions and partial terminations are thus beyond the scope of the Comptroller General's protest authority.

31 USCA § 3551 defines "protest" as follows:

> The term "protest" means a written objection by an interested party to any of the following:
>
> (A) A solicitation or other request by a Federal agency for offers for a contract for the procurement of property or services.
>
> (B) The cancellation of such a solicitation or other request.
>
> (C) An award or proposed award of such a contract.
>
> (D) A termination or cancellation of an award of such a contract, if the written objection contains an allegation that the termination or cancellation is based in whole or in part on improprieties concerning the award of the contract.

Into which of those categories did Poly-Pacific's complaint about the deductive change fit? There was no solicitation or other request for offers for the procurement of property or services; no solicitation or other request was cancelled; the modification did not make a new award for the purchase of property or services; and the modification was not a termination or cancellation based on an impropriety concerning the award of the contract. So what business did the Comptroller General have in becoming involved in this matter?

The contracting regulations permit Contracting Officers to terminate contracts in whole or in part, for convenience or default, when it is the Government's interest to do so. See FAR 49.101. Partial terminations are not limited to those that would have no effect on the scope of the contract. Indeed, one might argue that the purpose of a partial termination is to reduce the scope of the contract, and nothing in the language of any statute or regulation supports an interpretation to the effect that a CO must terminate a contract in its entirety instead of

Notes

terminating it in part if a partial termination would change the scope of the contract. We discussed deductive change orders versus partial terminations for convenience in *Deletion of Work—Change or Partial Termination?: Gotta Be This or That*, 2 N&CR ¶ 46. It is well-established that COs may use deductive change orders instead of partial terminations, and that whether to use a deductive change or a partial termination is a matter between the contracting parties—the issue being primarily one of settlement pricing.

Cardinal Changes And The Field Of Competition Logic

As Ralph pointed out in 19 N&CR ¶ 40, the Comptroller General's decision to sustain the protest in *Poly-Pacific* was based on the Comptroller's "field of competition" logic, through which the Comptroller looks to the contract as it is to be modified and compares it to the contract as awarded, and then determines whether or not the change is within scope, and thus whether the field of competition would have been different if the contract had been competed in the form in which it is to be modified. If the Comptroller finds that there is a change in scope, then the Comptroller assumes that a different set of competitors ("field of competition") would have submitted proposals and recommends that the agency either forgo the modification or terminate the contract and conduct a new competition. I think that this logic is unsound.

The fault in this logic lies in the Comptroller General's combination of the cardinal change doctrine with the notion of a "field of competition." Application of the cardinal change doctrine focuses attention on the contract as changed, instead of on the content of the modification. As the Comptroller put it in *Poly-Pacific*: "In determining whether a modification triggers the competition requirements in [the Competition in Contracting Act], our Office looks to whether there is a material difference between the modified contract and the contract that was originally awarded." The "field of competition" logic directs attention back to a completed contract formation process that is no longer of any relevance, assuming that it was done in compliance with statute and regulation. The focus ought to be on the content of the prospective modification: Does it add work? If so, is it new work?

The competition rules apply to new buys, but in *Poly-Pacific* there was no new buy—work was deleted. Yet the Comptroller General concluded that the agency should either forgo the deletion or terminate the contract in its entirety because the deletion changed the scope of the contract, notwithstanding the fact that the contract had been awarded a year before the deletion and that the deletion was in response to events that were not and could not have been foreseen before contract award. It is not reasonable to interpret CICA and FAR Part 6 as effectively prohibiting the partial termination of a contract—whether by deductive change or termination order—if it would change the scope of the contract in the course of its performance. The regulations expressly provide for partial contract terminations, and when a contract is partially terminated it is not going to be the contract for which offers were originally solicited. *Ever.* The effect of *Poly-Pacific* is to make all deductive changes and partial terminations subject to protest, no matter how long after award the modification is to be made and no matter what the reason for the modification.

***Poly-Pacific* Is Bad Law And Bad Policy**

In *Poly-Pacific,* the Comptroller General inserted the Government Accountability Office into a matter over which it has no protest jurisdiction—the administration of a contract after award when no new acquisition is involved. Complaints about purely deductive changes and partial terminations are not encompassed by the statutory definition of *protest*. The cardinal change/"field of competition" logic, faulty as it is, works fine when a modification would add work to a contract, but the facts in *Poly-Pacific* were distinguishable from such cases, and the protest should have been dismissed.

If a purely deductive change is made immediately after the award of the contract, it might suggest that the agency knew or should have known of the pending change before

Notes

award and therefore should have amended or cancelled the solicitation and sought revised or new offers in accordance with FAR 15.206. Failure to comply with FAR 15.206 during a source selection would be improper. But that was not the case in *Poly-Pacific*—the modification was made more than a year after the award and was not prompted by issues, conditions, or events that predated contract award. Must COs now look over their shoulders a year or longer into performance and worry that someone will protest an act of contract administration that does not involve the acquisition of new work?

The Comptroller General's *Poly-Pacific* decision is bad law and bad policy. Moreover, the Comptroller's assertion of jurisdiction in this matter was improper. We hope that the Air Force either sought reconsideration and dismissal of the protest or rejected the Comptroller's recommendations.

▼

¶ 49 • POSTSCRIPT: NEGOTIATION OF BETTER PRICES • In *Competitive Proposals: Negotiations Are Discussions But Discussions Are Not Necessarily Negotiations*, 15 N&CR ¶ 30, John criticized Contracting Officers for not negotiating lower prices with competitors that were in the competitive range and the Comptroller General for adopting a very permissive rule with regard to whether agencies were required to discuss high prices. We now have a decision where discussion of a high price was found to be mandatory, *Creative Information Technology, Inc*., Comp. Gen. Dec. B-293073.10, 2005 CPD ¶ 110, 47 GC ¶ 365. While the decision is a step in the right direction, it unfortunately does not include any significant guidance on the CO's obligations with regard to the discussion of high prices.

The *Creative Information* Case

The procurement in question was a "you-guess-what-we-need" solicitation for information management/information technology support services for more than 80 agencies and activities in the Army. The services were divided into six lots: (1) desktop support services, (2) application development, (3) audit and governance services, (4) business unit requirements, (5) strategic analysis, and (6) training. The offerors were to suggest "performance-based solutions" against a performance work statement. As might have been expected, the 12 offerors arrived at very disparate assessments of the amount of labor that would be required with the result that they proposed wildly varying prices—from a low of $10,603,679.20 to a high of $167,465,813.52. The CO placed the seven offerors that had submitted satisfactory technical proposals in the competitive range and conducted "discussions" by sending them each a letter identifying "weaknesses, deficiencies, questions/clarifications." With regard to the protester's price of $110,394,232.03, the letter included the following statement:

> Based on the Government['s] initial review of your proposed revised price/cost it appears that [your] total proposed price/cost is overstated for this requirement. Please review your revised price/cost proposal.

The final proposal revisions yielded equally disparate prices, with the low price being $10,603,679.20 and the protester's high price being $89,847,300.35. The award was made to two firms at prices of $10,603,679.20 and $19,389,897.00.

The Comptroller General Decision

The decision ignored the Federal Acquisition Regulation and stated the mandatory discussion rule in terms of pre-FAR Part 15 Rewrite decisions as follows:

> When contracting agencies conduct discussions with offerors in the competitive range, such discussions must be meaningful. *Kaneohe Gen. Servs., Inc*., B-293097.2, Feb. 2, 2004, 2004 CPD ¶ 50 at 3. In order for discussions to be meaningful, agencies must advise an offeror of weaknesses, excesses, or deficiencies in its proposal, correction of which would be necessary for the offeror to have a reasonable chance of being selected for award.

Notes

See our discussion in *Postscript IV: Negotiation in a Competitive Situation*, 16 N&CR ¶ 8, where we trace the history of the discussion rule starting with the key decision of the Comptroller General in *Department of the Navy—Reconsideration*, Comp. Gen. Dec. B-250158.4, 93-1 CPD ¶ 422, 72 Comp. Gen. 221 (the *Eldyne* case).

Having laid out the basic rule in this way, the Comptroller General then stated the application of the rule as it applied to high prices as follows:

> [W]ith regard to the adequacy of discussions of price, an agency generally does not have an obligation to tell an offeror that its price is high, relative to other offers, unless the government believes the price is unreasonable. *State Mgmt. Servs., Inc.; Madison Servs., Inc*., B-255528.6 et al., Jan. 18, 1995, 95-1 CPD ¶ 25 at 5–6; *Marwais Steel Co.*, B-254242.2, B-254242.3, May 3, 1994, 94-1 CD ¶291 at 6.

This was the rule that John criticized in 15 N&CR ¶ 30—noting that the test was sometimes formulated as whether the price was "unreasonably high" or "unrealistically high." See FAR 15.306(e)(3).

Whatever the test, the Comptroller General sustained the protest based on the following reasoning:

> By informing [the protester] only that its total price was "overstated," the Army failed to convey, in any meaningful way, the magnitude of the disparity in prices. Moreover, by characterizing the issue simply as one of price, the agency failed to address the underlying cause of [the protester's] unreasonable pricing— [the protester's] misconception of the level of effort anticipated by the Army for the lot V [strategic analysis] requirements. As a consequence, [the protester] could not reasonably have understood the agency's concern with its proposal or the fact that its proposal required fundamental changes in order to have a reasonable chance of being selected for award. Accordingly, the agency's discussions were not meaningful. [Citation omitted.]

We entirely agree with the outcome in this case. However, the decision does not leave us with a useful rule. It seems to us that whenever the agency sees a price *at which it would not award a contract*, the high price should be found to be a significant deficiency that requires discussion and that such discussion should include a probing of the reasons for the high price.

A Flawed Procurement

Aside from the meaningful discussion issue, this procurement is a clear example of a flawed contracting process. If an agency receives price proposals where the high price is 16 times the low price—with widely varying prices in between, it should be clear to any observer that there is something seriously wrong with the solicitation. But here the agency blindly went forward with the process.

Then the agency included seven offerors in the competitive range—which almost guaranteed that there would not be real discussions. This was the very thing that the FAR Council was trying to avoid when the FAR was rewritten in 1997. The idea was that only offerors with a real chance of winning would be put in the competitive range and then real negotiations would be held with them. But in this case, the agency demonstrated that it had not gotten the message.

Next, the agency conducted mickey-mouse discussions by sending letters to the seven offerors. We have often said in our teaching that if the offeror doesn't understand the solicitation, it is unlikely that it will understand a letter listing deficiencies and weaknesses. This was another issue that the FAR Council attempted to address in the Rewrite—using the term "negotiations" to signify that a CO should have real communication with offerors in the competitive range. See FAR 15.306(d). Again, the agency didn't get it.

It is true, these are generally not protest issues and the Comptroller General can't be expected to correct such a flawed procurement. But any agency that is competently managed would see from this procurement that serious work needs to be done to ensure that such poor procedures are not replicated.